



# Informing the audit risk assessment for Bromsgrove District Council

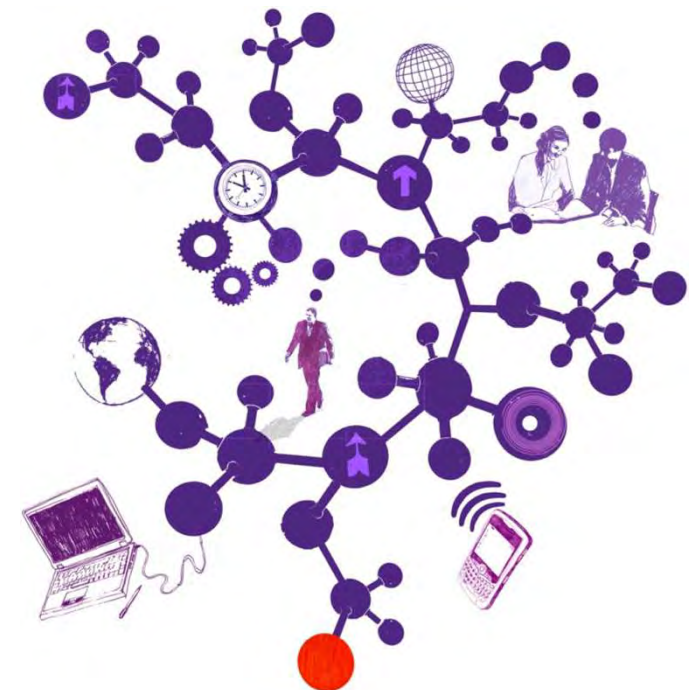
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## Year ended

31 March 2014

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# Purpose

The purpose of this report is to contribute towards the effective two-way communication between the Authority's external auditors and the Authority's Audit Board. The Cabinet retain the responsibility as 'those charged with governance' at Bromsgrove District Council, and the Audit Board supports them in that role. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Cabinet, through the Audit Board under auditing standards.

## Background

Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with the Audit and Standards Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit Board in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Audit Board and supports the Cabinet in fulfilling its responsibilities in relation to the financial reporting process.

## Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Audit and Standards Committee's oversight of the following areas:

- fraud
- laws and regulations
- going concern
- accounting estimates
- related parties.

This report includes a series of questions on each of these areas and the response we have received from the Authority's management. The Audit Board should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

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# Fraud

## Issue

### Matters in relation to fraud

ISA(UK&I)240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Audit Board and management. Management, with the oversight of the Audit Board, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit Board and Standards Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As the Authority's external auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with the Audit Board regarding its processes for identifying and responding to risks of fraud
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit Board oversees the above processes. We are also required to make inquiries of both management and the Audit Board as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the Authority's management.

# Fraud risk assessment

Question	
<p>1. What is officers' assessment of the risk of material misstatement in the financial statements due to fraud? Is this consistent with the feedback from your risk management processes?</p>	<p>Although there is an on-going risk of fraud being committed against the Council, arrangements are in place to both prevent and detect fraud. These include work carried out by Internal Audit on overall fraud risk areas and work on Council Tax and Housing Benefit fraud.</p> <p>There is on-going communication between external audit and responsible officers on emerging technical issues. Officers also attend technical updates.</p> <p>Financial monitoring reports also highlight areas of variance within the capital and revenue budgets and this assists management in identifying areas of material misstatement within the accounts.</p> <p>The Council is currently reviewing and updating its risk management processes and procedures.</p> <p>Management considers there is a low risk of material misstatement in the financial statements due to fraud.</p>
<p>2. Are you aware of any instances of fraud, either within the Council as a whole or within specific departments since 1 April 2013?</p> <p>If so how does the Audit Board respond to these?</p>	<p>There are some areas that are inherently at risk from fraud such as:</p> <ul style="list-style-type: none"> <li>■ Council Tax</li> <li>■ Benefit fraud</li> <li>■ Single person discount</li> </ul> <p>However, there is a dedicated benefits investigation team which investigates any fraud.</p> <p>The Audit Board receives any ad-hoc fraud reports.</p> <p>There are no material instances of fraud that have been identified during the year.</p>
<p>3. Do you suspect fraud may be occurring, either within the Council or within specific departments? Have you identified any specific fraud risks? Do you have any concerns there are areas that are at risk of fraud? Are there particular locations within the Council where fraud is more likely to occur?</p>	<p>Evidence published by the National Fraud Authority amongst others, suggests that fraud is committed in all organisations to varying degrees, so it is likely that some fraud is occurring in the Authority.</p> <p>Locations handling income, particularly in the form of cash, are more likely to be at risk of fraud. However management does not consider these to be significant risks.</p>

## Fraud risk assessment (continued)

Question	Management response
<p>4. Are you satisfied that the overall control environment, including: the process for reviewing the system of internal control; internal controls, including segregation of duties; exist and work effectively?</p> <p>If not where are the risk areas?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</p> <p>Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?</p>	<p>Yes - Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud.</p> <p>Sound systems of internal control with roles and responsibilities are defined in various places such as the Constitution.</p> <p>The role of internal audit, provides assurance that the Council's internal controls are in place. An annual report is produced and is available prior to the annual accounts being signed and approved</p>

## Fraud risk assessment (continued)

Question	Management response
<p>5. How do you encourage, and communicate to employees about your views on business practices and ethical behaviour?            How do you encourage staff to report their concerns about fraud?            What concerns are staff expected to report about fraud?</p>	<p>There is a Fraud Strategy and a Whistleblowing procedure in place which explain the procedures to follow.            Employees are aware of the anti-fraud of the anti-fraud and corruption strategy, details are available on the website.</p> <p>Management accepts that the fraud and corruption polices require updating and need to raise awareness across the Council</p>
<p>6. From a fraud and corruption perspective, what are considered to be high-risk posts?            How are the risks relating to these posts identified, assessed and managed?</p>	<p>There are not any significantly high-risk posts identified.</p>



## Fraud risk assessment (continued)

Question	
<p>7. Are you aware of any related party relationships or transactions that could give rise to instances of fraud? How do you mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>2012/13 financial statement disclosure of related party transactions does not identify potential fraud risk. Members and officers are required to make full disclosure of any relationships that impact on their roles. Members are required to declare any relevant interests at Council and Committee meetings.</p>
<p>8. What arrangements are in place to report fraud issues to Audit Committee? How does the Audit Board exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p>	<p>Internal Audit provide the Audit Board with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken. Any adhoc investigations are reported to the Audit Board</p>
<p>9. Are you aware of any whistleblowing reports under the Bribery Act since 1 April 2013? If so how does the Audit and Ethics Committee Respond to these?</p>	<p>None</p>

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# Laws and regulations

## Issue

### Matters in relation to laws and regulations

ISA(UK&I)250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Audit Board, is responsible for ensuring that the Authority's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit Board as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

## Impact of laws and regulations

Question	Management response
1. How does management gain assurance that all relevant laws and regulations have been complied with? What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?	The Monitoring Officer will advise the Council's Management team and Councillors as appropriate.
2. How is the Audit Board provided with assurance that all relevant laws and regulations have been complied with?	Assurance of complying with the Council's Constitution is provided through the Annual Governance Statement which is reported to Cabinet.
3. Have there been any instances of noncompliance with law and regulation since 1 April 2013 with and on-going impact on the 2013/14 financial statements?	None
4. Is there any actual or potential litigation or claims that would affect the financial statements?	These are included in the financial outturn statements
5. What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	The officers within legal and financial services assess the impact of any claims
6. Have there been any report from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	None

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# Going Concern

## Issue

### **Matters in relation to going concern**

ISA(UK&I)570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

Going concern considerations have been set out below and management has provided its response.

## Going concern considerations

Question	Management response
1. Has a report been received from management forming a view on going concern?	The Director of Finance and Corporate Resources (as s151 Officer) is satisfied that the budget proposals are based on robust estimates, and that the level of reserves is adequate. This was reported in the Medium Term Financial Strategy.
2. Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the Council's Business Plan and the financial information provided to the Council throughout the year?	The Financial Plan is agreed at the same time as the Council Strategic Purposes. The financial plan makes clear reference to the Purposes as the basis for the financial considerations in setting the medium term budget. The financial assumptions are therefore consistent with the Purposes. Reports in year are consistent with the budget set.
3. Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	The financial plan considered the government changes in terms of grants. The plan sets out the likely implications of the Governments Resources Review and other changes to local government finance, such as the new Council Tax Support scheme and other Council tax reforms being implemented from 1st April 2013 in addition to the Business rates retention scheme.
4. Have there been any significant issues raised with the Audit Board during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No
5. Does a review of available financial information identify any adverse financial indicators including negative cash flow or poor or deteriorating performance against the better payment practice code? If so, what action is being taken to improve financial performance?	No

## Going concern considerations (continued)

Question	Management response
<p>6. Does the Council have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council's objectives? If not, what action is being taken to obtain those skills?</p>	yes
<p>7. Does the Council have procedures in place to assess the Council's ability to continue as a going concern?</p>	Yes as above
<p>8. Is management aware of the existence of events or conditions that may cast doubt on the Council's ability to continue as a going concern?</p>	No
<p>9. Are arrangements in place to report the going concern assessment to the Audit Board? How has the Audit Board satisfied itself that it is appropriate to adopt the going concern basis in preparing financial statements?</p>	

# Related Parties

## Issue

### Matters in relation to Related Parties

Local Authorities are required to comply with IAS 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the authority (i.e. subsidiaries);
- associates;
- joint ventures;
- an entity that has an interest in the authority that gives it significant influence over the authority;
- key management personnel, and close members of the family of key management personnel, and
- post-employment benefit plans (pension fund) for the benefit of employees of the authority, or of any entity that is a related party of the authority.

A disclosure is required if a transaction (or series of transactions) is material on either side, i.e. if a transaction is immaterial from the Authority perspective but material from a related party viewpoint then the Authority must disclose it.

ISA (UK&I) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

# Related Parties

Question	Management response
<p>What controls does the Authority have in place to identify, account for and disclose related party transactions and relationships ?</p>	<p>A number of arrangements are in place for identifying the nature of a related party and reported value including:</p> <ul style="list-style-type: none"><li>■ Maintenance of a Register of interests for Members, a register for pecuniary interests in contracts for Officers and Senior Managers requiring disclosure of related party transactions.</li><li>■ Annual return from senior managers/officers requiring confirmation that read and understood the declaration requirements and stating details of any known related party interests.</li><li>■ Review of in-year income and expenditure transactions with known identified related parties from prior year or known history.</li><li>■ Review of the accounts payable and receivable systems and identification of amounts paid to/from assisted or voluntary organisation</li><li>■ Review of year end debtor and creditor positions in relation to the related parties identified.</li><li>■ Review of minutes of decision making meetings to identify any member declarations and therefore related parties.</li></ul>



# Accounting estimates

## Issue

### Matters in relation to accounting estimates

Local Authorities apply appropriate estimates in the preparation of their financial statements. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Authority identifies the transactions, events and conditions that may give rise to the need for an accounting estimate.

Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. We need to be aware of all estimates that the Authority is using as part of its accounts preparation; these are detailed in appendix 1 to this report. The audit procedures we conduct on the accounting estimate will demonstrate that:

- the estimate is reasonable; and
- estimates have been calculated consistently with other accounting estimates within the financial statements.

We would ask the Audit Board to satisfy itself that the arrangements for accounting estimates are adequate.

## Question

## Management response

Are management aware of transactions, events, conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement (other than those in Appendix A)?

No

Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?

Yes

How is the Audit Board provided with assurance that the arrangements for accounting estimates are adequate ?

Yes

## Appendix A Accounting Estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Property plant & equipment valuations	The Council has a contract with Worcestershire County Council property department to manage its asset base, including undertaking annual valuations. The Valuer is a RICS/CIB Member) and reviews are made inline with RICS guidance on the basis of 5 year valuations with interim reviews	Capital Accountant notifies the valuer of the program of rolling valuations or of any conditions that warrant an interim re-valuation.	Yes, the Worcestershire County Council valuer, and officers there are RICS qualified	Valuations are made in-line with RICS guidance - reliance on expert	No
Estimated remaining useful lives of PPE	The following asset categories have general asset lives: <ul style="list-style-type: none"> <li>■ Buildings 50 years</li> <li>■ Equipment/vehicles 5 years</li> <li>■ Plant 12 years</li> <li>■ Infrastructure 40 years.</li> </ul>	Consistent asset lives applied to each asset category.	Yes, the Worcestershire County Council valuer	The method makes some generalisations. For example, buildings tend to have a useful life of 50 years. Although in specific examples based upon a valuation review, a new building can have a life as short as 25 years or as long as 70 years depending on the construction materials used. This life would be recorded in accordance with the local qualified RICS or CIB Member.	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Depreciation and Amortisation	Depreciation is provided for on all fixed assets with a finite useful life on a straight-line basis	Consistent application of depreciation method across all assets	No	<p>The length of the life is determined at the point of acquisition or revaluation according to:</p> <ul style="list-style-type: none"> <li>■ Assets acquired in the first half of a financial year are depreciated on the basis of a full year's charge; assets acquired in the second half are not depreciated until the following financial year.</li> <li>■ Assets that are not fully constructed are not depreciated until they are brought into use.</li> </ul>	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Impairments	Assets are assessed at each year-end as to whether there is an indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, here this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.	Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired	Worcestershire County Council Valuer.	Valuations are made in-line with RICS guidance - reliance on expert.	No
Measurement of Financial Instruments	Council values financial instruments at fair value based on the advice of their external treasury consultants	Take advice from professionals	Yes	Take advice from treasury management professionals	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Overhead Allocation	The Finance team apportion central support costs to services based on fixed bases as detailed in the 'Allocation Summary' spread sheet.	All support service cost centres are allocated according to the agreed 'Allocation Summary' spread sheet.	No	Apportionment bases are reviewed each year to ensure they are equitable.	No.
Provisions for liabilities	Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation.  Provisions are charged as an expense to the appropriate service line in the CIES in the year that the Council becomes aware of the obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.	Charged in the year that the Council becomes aware of the obligation	No	Estimated settlements are reviewed at the end of each financial year – where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service. Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received by the Council.	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Accruals	The finance team collate accruals of Expenditure and Income. Activity is accounted for in the financial year that it takes place, not when money is paid or received.	Procedures for identifying accruals are included in the closedown instructions	No	Accruals for income and expenditure have been principally based on known values. Where accruals have had to be estimated the latest available information has been used.	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
PFI schemes and similar contracts	NA				

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Non Adjusting events – events after the balance sheet date	S151 officer makes the assessment. If the event is indicative of conditions that arose after the balance sheet date then this is an un-adjusting event.  For these events only a note to the accounts is included, identifying the nature of the event and where possible estimates of the financial effect.	Heads of Services notify the S151 Officer	This would be considered on individual circumstances	This would be considered on individual circumstances	N/A
Defined benefit pension amounts and disclosures	Non-teaching staff are members of the Local Government Pensions Scheme, administered by Worcestershire County Council.	Rely on the calculations made by the actuary	The actuary of the pensions scheme	Reliance on the expertise of the actuaries of the pension scheme	No



## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Pension Fund Actuarial Gains/Losses	The actuarial gains and losses figures are calculated by the actuarial experts. These figures are based on making % adjustments to the closing values of assets/liabilities	For the LGPS the Authority responds to queries raised admitted bodies of the pension fund.	The Authority are provided with an actuarial report.	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	No



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